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Diligence Decoded: Preparing to Be Investor-Ready



Knowledge Series

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❖ Introduction

This knowledge series demystifies the essentials of due diligence for business owners, investors, and promoters. From financial checks to operational insights, we will explore the tools and techniques that help uncover risks and opportunities. Whether you are buying, investing, or scaling—make informed decisions with confidence, backed by smart diligence practices.

❖ What is Due Diligence?



Due diligence is the systematic process by which a prospective buyer (investor) thoroughly investigates a target company's operations, finances, and risks before completing a transaction. It is one of a merger or acquisition's most critical and comprehensive processes. The goal is to verify that the seller's information is accurate, uncover any hidden liabilities or risks, and assess the company's true value.

❖ What is the Purpose of Due Diligence?

- The primary purpose of due diligence is to provide the purchaser or investor with a comprehensive understanding of the business they are planning to acquire or invest in. This involves collecting, reviewing, and analysing all relevant information—financial, legal, operational, and strategic—so that the interested party can assess the true value, risks, and opportunities involved.

- Due diligence helps in evaluating the strengths and weaknesses of the business. It identifies the critical success factors that drive growth and sustainability while also uncovering any hidden problems that might negatively impact the transaction. These could include undisclosed liabilities, pending litigations, compliance issues, or inflated performance claims.
- By minimizing uncertainties, due diligence reduces the likelihood of post-transaction disputes or costly surprises, ultimately protecting both the financial and reputational interests of the buyer.

❖ Why Due Diligence is Important?

Due diligence is not merely a legal formality—it is a strategic safeguard. Here is why it is indispensable in any major business transaction:

1. To Confirm Authenticity

Due diligence ensures that the business is genuinely what it claims to be. This includes validating revenue streams, examining customer contracts, inspecting physical and digital assets, and confirming operational capabilities.

2. To Identify Deal Breakers

These are critical flaws or risks that could make the deal unattractive or too dangerous to pursue. These may include legal disputes, tax irregularities, underreported debts, or non-compliance with regulations.

3. To Support Valuation and Negotiation

By uncovering the real financial health of the target company, due diligence allows the buyer to propose a price that reflects the true value. It also helps determine appropriate representations, warranties, indemnities, and other safeguards in the agreement.

4. To Ensure Regulatory and Strategic Alignment

Due diligence checks whether the company complies with relevant laws (tax, labour, environment, etc.) and whether it aligns with the buyer's strategic goals, culture, and long-term vision.

❖ Classification of Due Diligence: -



1. Financial Due Diligence

It examines the company's financial health and historical performance. Its objective is to verify the accuracy of reported financial statements, to assess profit trends, liquidity, and solvency, and to identify any irregularities or off-balance-sheet items. The work typically covers past financials and forward-looking forecasts. A thorough financial due diligence report will summarize findings, highlight any discrepancies, and quantify risk.

2. Legal Due Diligence

It seeks to uncover any legal risks or compliance issues that could affect the deal. Its objective is to verify that the target company is properly organized, operates in compliance with laws and regulations, and has valid contracts and intellectual property. Legal due diligence involves a

comprehensive review of a target company's business, legal, financial, operational, and other relevant details to evaluate its suitability for acquisition. It identifies legal risks, pending claims, or compliance gaps that may impact deal value or post-acquisition liabilities.

3. Commercial Due Diligence

It assesses the business from a market and strategic standpoint. The objective is to understand the target's market position, growth prospects, customer base and competitive dynamics. It confirms revenue sustainability and market competitiveness, guiding valuation and strategic fit.

4. Tax Due Diligence

It evaluates the target's tax positions to identify any liabilities or opportunities. The objective is to determine the maximum potential tax exposure and ensure that all taxes have been correctly calculated and paid. It examines historical tax compliance and how the transaction itself may impact future tax obligations. It uncovers any hidden tax obligations and ensures the buyer is aware of current and future tax impacts of the transaction.

5. Operational Due Diligence

It investigates the company's day-to-day operations and internal processes. Its objective is to determine whether the operations are efficient, scalable, and well-organized. Operational diligence will flag any inefficiencies that could hurt future performance.

6. Human Resources Due Diligence

Human resources (HR) due diligence reviews the company's workforce and related liabilities.

The objective is to understand employee-related risks and costs, as well as any retention or cultural issues. HR diligence ensures the buyer knows whom they are acquiring and any employment-related contingencies.

7. Information Technology Due Diligence

It examines the target company's information technology and data security environment. The objective is to ensure that the company's IT infrastructure is dependable, scalable, and secure. It looks at whether the IT systems can support current operations and future growth, and whether there are any significant vulnerabilities.

8. Intellectual Property Due Diligence

It focuses on the company's intangible assets: patents, trademarks, copyrights, trade secrets and related licenses. The objective is to confirm that the target owns or properly licenses its key intellectual property and that there are no unresolved disputes. Since intellectual property can be a large part of a company's value, it must ensure these rights are clear and enforceable. It ensures that valuable intellectual property is properly protected and transferrable, reducing risk of infringement or value loss.

9. Environmental Due Diligence

Environmental due diligence assesses compliance with environmental laws and the existence of any ecological liabilities. The objective is to identify contamination risks or regulatory violations that could impose cleanup costs or fines. Overlooking environmental issues can jeopardize the entire deal.

❖ How to Prepare for Due Diligence?

1. Start by Understanding What Due Diligence Covers.

Before diving into documents, take a step back and understand what kind of due diligence will be carried out. Are they focusing on financials? Legal contracts? Tax compliance? Or a bit of everything? Knowing this helps you prepare better. For instance, if it's an investor, they may want to focus on growth and numbers. If it's a merger, they'll go deep into legal and operational matters too. Understanding the scope helps you involve the right people and gather only what's needed to save everyone's time.

2. Build a Strong Core Team – Led by Finance and Compliance

A well-structured team is the foundation of smooth due diligence. Begin by identifying key individuals from finance, legal, HR, operations, and IT those who understand the company's internal workings and documentation thoroughly. Appoint a central coordinator to manage communication, timelines, and document flow. Depending on the scope of diligence, it may also be helpful to involve external experts such as a CA, CS, or legal advisor. Having domain experts available to provide documents, respond to queries, and explain key aspects ensures efficiency, accuracy, and confidence throughout the process.

3. Get All Your Documents in One Place

This part is about getting organized. Create a central folder or virtual data room (VDR) and sort documents category-wise—corporate, financial, legal, tax, HR, and so on. Think of it like a well-arranged filing cabinet. Your financials (like audited reports and MIS), tax returns, GST filings, contracts, employee

lists—everything should be there and clearly labeled. This saves a lot of back-and-forth and gives a great first impression to the diligence team.

4. Do an Internal Review First

Once your documents are in place, do not rush to share them. Review everything internally first. Are there any mismatches between your trial balance and audited statements? Is there an outdated contract in the folder? Is any compliance overdue? Clean up what you can. If you spot issues that cannot be fixed right away, at least be ready with a proper explanation. Some companies even do a “mock due diligence” internally—it is a great way to spot weak points before someone else does.

5. Be Ready with Answers, Not Just Files

Documents are important, but so are the stories behind them. The other side will have questions: Why did revenue drop last quarter? Why is there a delay in tax filings? What is the status of that litigation? Prepare short, clear answers for common questions related to financials, compliance, legal matters, and key contracts. If multiple people are involved, make sure everyone is aligned with the same version of the story—consistency is key.

6. Keep Sensitive Information Secure

Remember, due diligence often involves confidential data—your financials, legal contracts, employee details. Do not share documents casually on email. Use a secure platform (like Google Drive with permissions, or a proper VDR). Control who can access what and keep a log of who is viewing what. Also, clearly mark confidential files so there is no confusion. It is not just about security, it also shows you take your data seriously.

7. Stay in Sync and Communicate Often

Smooth due diligence needs coordination. Assign one person to manage communication with the external party—they will track requests, share updates, and avoid duplication. Internally, schedule regular check-ins with your team to track progress: What is done, what is pending, and what needs clarification. This avoids last-minute chaos and keeps everyone on the same page.

8. Be Honest and Proactive

Every company has some flaws—and that is okay. What matters is how upfront you are about them. If there is a compliance gap, a pending case, or a financial concern, share it with context and explain what is being done about it. Hiding issues only raises red flags later. Being transparent shows maturity, builds trust, and can even improve your chances of getting a deal done.

❖ Key Compliance Areas –

Below is an overview of the key compliance areas that every organization should focus on:

1. Income Tax Compliances

Income tax compliance extends beyond the mere filing of returns. It requires organizations to adopt a holistic approach toward tax planning, deduction tracking, and proper disclosure. Timely filing of Income Tax Returns (ITRs) and Tax Audit Reports (under Section 44AB) is a legal obligation and failure to adhere can attract penalties and scrutiny.

Equally important is the compliance around Tax Deducted at Source (TDS) and Tax Collected at Source (TCS). Entities must ensure TDS is deducted/ TCS is collected at prescribed rates, paid within due dates, and

correctly reported through quarterly TDS & TCS returns (such as Form 24Q, 26Q, 27Q and 27EQ).

Reconciliation of TDS statements with Form 26AS and the Annual Information Statement (AIS) is essential to prevent mismatches that may trigger notices. Moreover, companies must maintain detailed records of capital gains on asset sales—such as land, buildings, securities—and ensure correct computation and disclosure in returns.

If the entity is under scrutiny or has past tax demands, proactive steps should be taken for resolution through proper legal or appellate routes to avoid future complications.

2. Goods and Services Tax (GST) Compliances

GST, being a transaction-based tax, requires meticulous month-on-month compliance. Timely and accurate filing of GSTR-1 (outward supply), GSTR-3B, and GSTR-9/9C forms are the backbone of GST governance. Mismatches between GSTR-3B and GSTR-2B can result in disallowed credits, penalties, and unnecessary departmental attention. Kindly ensure no ineligible ITC under Section 17(5) is claimed and credit is availed as per Rule 16(4) timelines and Rule 36(4) conditions to avoid future notices

For entities crossing prescribed turnover thresholds, e-invoicing and e-way bill generation become mandatory. Businesses must ensure that e-invoices are raised in real time, and movement of goods is backed by valid e-way bills to avoid detention or seizure during transit.

Additionally, reconciliations between GST returns and financial books should be performed monthly to identify omissions or excesses. Addressing GST notices, audits, and assessments promptly, with proper

documentation, helps maintain a compliant and low-risk GST profile.

3. Companies Act & ROC Compliances

The Companies Act, 2013, places a strong emphasis on transparency, disclosures, and procedural compliance. Key ROC filings such as AOC-4 (for filing the financial statements), MGT-7 (for filing the annual return), PAS-3 (for reporting of allotment of shares), DIR-3 KYC (for KYC of directors), and other event-based forms must be submitted within prescribed deadlines to avoid penalties and compounding provisions.

Statutory registers such as the Register of Members, Register of Directors, and Register of Charges must be kept updated and made available for inspection as required.

Minutes of Board and Shareholder Meetings must be maintained in prescribed format and signed within stipulated time frames.

Where secretarial audit is applicable, the same must be conducted by a qualified Company Secretary and findings appropriately addressed by management.

4. Legal & Contractual Compliances

Registered lease deeds, vendor and customer contracts, and third-party service agreements must be valid, enforceable, and aligned with current business operations. Intellectual property rights (IPRs) must be properly assigned and protected under valid agreements.

Additionally, employment and service contracts should include non-compete clauses, confidentiality agreements, and clear termination/resignation conditions to protect the company's interests.

A consolidated litigation tracker should be maintained, highlighting the status of civil, criminal, labour, or tax-related proceedings.

5. Financial & Accounting Controls

Sound financial reporting practices form the foundation of stakeholder trust. Audit reports issued by statutory auditors must ideally be free of qualifications, adverse opinions, or emphasis of matter paragraphs.

Consistency in revenue recognition—whether under Accounting Standards (AS) or Indian Accounting Standards (Ind AS)—is critical, especially in sectors like real estate, construction, software, or subscription-based models.

Compliance with transfer pricing norms and appropriate documentation of related party transactions (RPTs) ensures that intra-group dealings are at arm's length and not subject to tax disallowances.

Proper inventory valuation methods and physical verification of both inventories and fixed assets must be done periodically and discrepancies, if any, should be investigated and recorded.

Implementation of robust internal financial controls (IFC) is essential not just for audit readiness, but also for safeguarding against fraud and misstatements.

6. Regulatory and Sector-Specific Licenses

Depending on the industry, businesses may be subject to additional sectoral regulations that must be carefully monitored. For instance, food businesses require valid FSSAI registration; export-import traders need IEC codes; manufacturing units dealing with standards must be registered under BIS;

financial service providers must comply with RBI, SEBI, or IRDA regulations, as applicable.

All licenses and registrations should be valid and regularly renewed before expiry. Businesses should maintain a license master list with renewal dates and compliance requirements. Regulatory notices or show cause letters, if received, must be responded to within timelines with appropriate documentation to avoid cancellation or suspension of licenses. A proactive approach to regulatory compliance reduces the risk of operational disruptions and reputational damage.

❖ Conclusion –

In conclusion, due diligence is more than just a procedural formality—it is a strategic necessity for investors, buyers, and business owners alike. It provides a 360-degree view of a company's financial, legal, operational, and strategic health, enabling stakeholders to make informed decisions with confidence. By uncovering hidden risks, validating key information, and ensuring regulatory compliance, due diligence helps prevent costly surprises post-transaction. Proper preparation, such as organizing documentation, conducting internal reviews, and maintaining transparent communication, plays a crucial role in ensuring a smooth and efficient diligence process. Furthermore, focusing on core compliance areas—like income tax, GST, ROC filings, and industry-specific regulations—not only strengthens internal governance but also enhances credibility in the eyes of investors and partners. Ultimately, effective due diligence protects the interests of all parties involved and lays the foundation for a successful transaction and long-term business sustainability. Being proactive and honest in this process is key to its success.

❖ **Compliance Calendar for the month of June 2025**

Sr. No.	Date	Compliance
1	07-06-2025	ECB-2 Return Payment of TDS/TCS
2	08-06-2025	NABARD Subsidy
3	10-06-2025	Filing of Form APR GSTR-7/8
4	11-06-2025	GSTR-1
5	13-06-2025	GSTR-6
6	15-06-2025	ESIC Payment and Return, Issue of TDS Certificate u/s 194IA and IB, Payment of Advance Tax, Provident Fund Payment and Return
7	20-06-2025	GSTR-3B, GSTR-5 & 5A, Monthly Payment of Profession Tax (Karnataka)
8	21-06-2025	Monthly Payment of Profession Tax
9	25-06-2025	GSTR-3B-Monthly, Payment- QRMP
10	28-06-2025	GSTR-11
11	29-06-2025	NDH-1 Return of Statutory Compliances
12	30-06-2025	Certificate in respect of Income arising on Indirect Transfer of Shares in/through which the foreign Co./Entity, DPT-3 Deposits of Company, Monthly Return for Profession Tax more than 1,00,000/-TDS payment 194IA and 194IB

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❖ **Special Mention:**

Thank you, **Piyush Jadhav, Shantanu Bajare, Siddhant Jori, Varad Kabra and Varad Zanwar** for the compilation of this knowledge series.

❖ **RRCO Corner:**

Chak De RRCO – A Day dedicated to reliving school time memories and strengthening team spirit through the joy of sports.

